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21 June 2019.

Sent by email to: RIIO-ED1@ofgem.gov.uk

Dear Victoria,

Informal consultation on RIIO-ED1 price control reopeners (May 2019)

Thank you for the opportunity to respond to the above consultation. This is a non-confidential response on behalf of the Centrica Group.

It is important that the submissions satisfy the qualifying criteria and any adjustment is justified, efficient and represents value for money from the consumer perspective:
Reopeners are a type of uncertainty mechanism and were designed to allow certain categories of expenditure allowances to be adjusted during the RIIO-ED1 price control once there was sufficient certainty about the need for and the associated levels of expenditure. This, effectively, allows discrete elements of the RIIO-ED1 settlements to be revisited.

RIIO-1 price control review arrangements include an incentive (the Information Quality Incentive or IQI) that is designed to encourage companies to provide accurate and ambitious cost forecasts. The IQI seeks to ensure that the optimal position is to seek funding at an efficient level (and so companies would be worse off seeking funding above the level that is justified) There is not an equivalent mechanism for reopener applications, meaning companies are no worse off submitting applications that are not justified. This means there is an even greater onus on Ofgem to ensure any adjustment is justified, efficient and represents value for money from the consumer perspective. For RIIO-2, we recommend a methodology for encouraging companies to propose only adjustments that genuinely meet the qualifying criteria and intent of the respective reopeners and to provide only accurate and ambitious cost forecasts in submissions, especially since a greater number of reopeners may be included in the RIIO-2 settlements.

The policy for the funding of Rail Electrification costs should be confirmed:
We note two companies proposed adjustments via the Rail Electrification reopener. The companies' views differ as to whether a policy decision has been made about how diversions should be funded and whether it has been confirmed electricity consumers should fund those costs. It would have been helpful if the policy relating to funding was confirmed ahead of the 2019 reopener window. Nevertheless, we acknowledge ex-ante expenditure allowances have been provided on an interim basis in the RIIO-ED1 settlement and Ofgem has confirmed the funding will be returned to consumers if the works are to be funded by a third party. If additional allowances are provided via this reopener, this should be done on the same proviso. Additionally, we recommend Ofgem retains the ability to return funding to consumers beyond the end of the RIIO-ED1 price control, in the event the relevant policy decision is made after March 2023.

We present our assessment of the submissions in the attached appendices. I hope you find these comments helpful. Please contact me if you would like to discuss any aspect of our response.

Yours sincerely,

Andy Manning
Director - Network Regulation and Forecasting
Centrica Regulatory Affairs, UK & Ireland

APPENDIX 1:
Assessment of High Value Project Costs submissions

SPEN (SPD and SPMW) – 33kV Cable Systems

1. Does the submission meet the qualifying criteria set out in Special Licence Condition CRC3.F of the network companies' licences?

We do not believe this submission meets all the qualifying criteria. The proposed adjustments do not relate to an individual scheme. The High Value Projects (HVP) reopener was designed to allow adjustments for individual schemes of £25m or more not included as part of ex ante allowances[1]. Subsequently, in existing guidance, HVP costs have been defined as:

> *…scheme of works and the associated costs incurred, or expected to be incurred, by the licensee on any investment project with respect to its Distribution System that is reasonably forecast to cost the licensee £25 million or more (in 2012/13 prices) during the Price Control Period...*[2]

Additionally, although 'scheme' is not a defined term, the types of projects considered within the scope of the HVP assessment as a part of the closeout of the fifth electricity distribution price control (DPCR5) can provide guidance. Those projects were one-off discrete or transformative projects[3]. Portfolios of asset management activities were not considered to be HVPs.

SPEN's submission relates to a portfolio of asset management activities to address the premature failure of a type of cable joint across both licence areas. We do not believe treating a portfolio of asset management activities equivalently to an individual scheme aligns with the underlying policy intent of this mechanism or the wording in the *ED1 Price Control Financial Handbook for slow-track licensees* (hereafter referred to as the *Handbook*).

3. Does the submission provide adequate evidence that the planned expenditure is economic and efficient?

The planed expenditure relates to assets that have lasted no more than a third of their expected life. The fact that SPEN adopted a procurement strategy that precludes it from approaching the supplier for remediation was entirely within its control. This means the new planned expenditure is the result of previous inefficient asset procurement and is neither economic nor efficient. As such, consumers should not be required fund the planned expenditure. This is discussed further below.

[1] "Strategy decision for the RIIO-ED1 electricity distribution price control - Uncertainty mechanisms"; page 22: https://www.ofgem.gov.uk/sites/default/files/docs/2013/02/riioed1decuncertaintymechanisms_0.pdf.
[2] "ED1 Price Control Financial Handbook (slow-track licensees)"; paragraph 7.21: https://www.ofgem.gov.uk/system/files/docs/2017/08/ed1_handbook_v3_slowtrack_0.pdf.
[3] See Table 2.3 in "DPCR5 Close out: Consultation on proposed adjustments". (https://www.ofgem.gov.uk/system/files/docs/2017/06/dpcr520close20out20public20consultation20final1_0.pdf)

4. Is there any other relevant information we should consider before making our determination?

SPEN's procurement strategy:
We do not believe this submission should be considered. SPEN's submission relates to a portfolio of asset replacement activities to address the premature failure of a particular type of cable joint across both licence areas. SPEN states:

> *Against an expected service life of 40-45 years, these joints exhibit failure 10-15 years after installation, with 6% of the entire population failing in the summer of 2018 alone.*[4]

SPEN has attributed the premature failure to a manufacturing and design deficiency, common to all joints of this particular type and date range[5]. SPEN also notes it was the first DNO (group) to adopt this type of joint design and is the only to be affected by this issue[6]. SPEN states that, despite the premature failure being due to a manufacturing and design deficiency, the supplier cannot be made to bear the rectification costs because:

> *In line with typical DNO procurement strategy, SPEN are unable to recover incurred costs from the supplier due to the nature of the contractual terms required to achieve unit cost in line with industry allowances.*[7]

In previous price control settlements, SPEN was provided with expenditure allowances to deliver relevant outputs and was allowed discretion about how those outputs were delivered. As such, SPEN was expected to manage those risks. We note SPEN under-spent ex-ante allowances by 11% (£220m) and 6% (£135m) for the fourth and fifth electricity distribution price controls respectively[8]. This means it does not seem credible that allowances were insufficient to ensure appropriate safeguards were written into contracts.

It is not appropriate for consumers to be required proposed adjustment, for assets that have lasted no more than a third of their expected life. The fact that SPEN adopted a certain procurement strategy that appears to preclude it from approaching the supplier for remediation was entirely within its control. Additionally, based on the evidence in the submission, it is not clear whether SPEN continued to install this type of joint after premature failures were first observed.

Foreseeability of the issue:
SPEN states the proposed adjustments are due to factors beyond its control and could not have been foreseen ahead of the RIIO-ED1 price control. We disagree. The evidence presented

[4] SPEN's 33kV Cable Systems submission, page 5.
[5] SPEN's 33kV Cable Systems submission, page 5.
[6] SPEN's 33kV Cable Systems submission, page 5.
[7] SPEN's 33kV Cable Systems submission, page 8.
[8] Data taken from https://www.ofgem.gov.uk/sites/default/files/docs/dpcr5_performance_report_2010-2015_data_table.xlsx.

demonstrates 64 failures were recorded during the first four years of DPCR5[9], after which RIIO-ED1 business plans were being developed. Also, SPEN states:

> *In DPCR5, SPD experienced an average of 5.2 trifurcating joint failures/annum, and SPMW experienced an average of 14.0 failures/annum.*[10]

The need for some expenditure, whether funded by consumers or by SPEN itself, during RIIO-ED1 to rectify this issue was foreseeable given the premature failures recorded between 2010 and 2014. This means SPEN should have foreseen this need. SPEN could have suggested a bespoke uncertainty mechanism which allowed it to propose an adjustment once there was greater certainty of the level of expenditure required. Further, we note the Link Boxes uncertainty mechanism was developed after the 'slow-track' DNOs submitted revised business plans[11].

Treatment of this asset type in the DPCR5 closeout:
Clarity should be provided on how this type of asset was treated for the purposes of the DPCR5 closeout. Particularly, it should be explained whether these assets contributed to SPEN exceeding its risk reduction targets given those assets now require replacement or remediation.

SPEN (SPMW) – High Speed 2

1. Does the submission meet the qualifying criteria set out in Special Licence Condition CRC3.F of the network companies' licences?

We do not believe this submission meets all the qualifying criteria. The proposed adjustments do not relate to an individual scheme. The HVP reopener was designed to allow adjustments for individual schemes of £25m or more not included as part of ex ante allowances[12]. Subsequently, in existing guidance, HVP costs have been defined as:

> *…scheme of works and the associated costs incurred, or expected to be incurred, by the licensee on any investment project with respect to its Distribution System that is reasonably forecast to cost the licensee £25 million or more (in 2012/13 prices) during the Price Control Period...*[13]

SPEN's submission relates to a portfolio of load-related schemes to increase network capacity across its Manweb region because of the expected growth in demand linked to HS2. In the submission, SPEN describes the driver for reinforcement across its region:

[9] SPEN's 33kV Cable Systems submission, page 4.
[10] SPEN's 33kV Cable Systems submission, page 4.
[11] "RIIO-ED1: Final determinations for the slow-track electricity distribution companies"; paragraphs 6.10-6.11: https://www.ofgem.gov.uk/sites/default/files/docs/2014/11/riio-ed1_final_determination_overview_-_updated_front_cover_0.pdf.
[12] "Strategy decision for the RIIO-ED1 electricity distribution price control - Uncertainty mechanisms"; page 22.
[13] "ED1 Price Control Financial Handbook (slow-track licensees)"; paragraph 7.21.

> *The HS2 project will increase electrical demand within the SPMW licence area. This demand increase consists of the demand associated with HS2 (the construction works to deliver the project and the enduring load of the project), and the regional economic growth directly resulting from improved transport links created by the project. SPMW will need to create additional network capacity to accommodate this demand.*[14]

SPEN acknowledges the submission relates to a portfolio of reinforcement schemes. SPEN states:

> *Extensive network planning studies have been undertaken to assess the minimum holistic network requirements across the whole affected area, and to propose efficient coordinated reinforcement schemes to meet this new demand.*[15]

Further, SPEN has identified the required reinforcement schemes[16]. SPEN acknowledges the wording in the *Handbook* but has adopted an alternative interpretation. SPEN proposes that HS2 should be treated as the 'scheme' and the proposed reinforcement projects are 'works associated with the scheme'[17]. We believe this is incorrect and does not align with the with the underlying policy intent of this mechanism or the wording in the *Handbook*.

2. Does the submission provide adequate evidence that the planned expenditure is necessary?
3. Does the submission provide adequate evidence that the planned expenditure is economic and efficient?

The non-confidential submission does not provide adequate evidence that all the planned expenditure is necessary or is economic and efficient. The proposed adjustments are based on traditional reinforcement solutions. However, SPEN has committed to investigating whether flexibility services offer lower lifetime costs and adopting those services if this is expected to be the case. This means the estimate of planned expenditure may not be efficient from the consumer perspective since it is possible the increase in capacity across the Manweb region could be delivered at lower cost if flexibility services are used.

Consideration of the proposed adjustment may be premature at this stage since SPEN has not yet incurred expenditure and no other DNO has yet proposed an adjustment despite HS2 being expected to traverse other licence areas.

4. Is there any other relevant information we should consider before making our determination?

In its submission, SPEN mentions the Load-Related Expenditure (LRE) reopener was considered but discounted. We believe the LRE reopener is clearly the appropriate mechanism through which

[14] SPEN's HS2 HVP & Rail Electrification submission, page 5.
[15] SPEN's HS2 HVP & Rail Electrification submission, page 11.
[16] SPEN's HS2 HVP & Rail Electrification submission, table 3-6.
[17] SPEN's HS2 HVP & Rail Electrification submission, page 15.

SPEN should propose adjustments. Additionally, the LRE reopener offers consumers some protection in the event the assumed increase in demand does not materialise, since "*only costs incurred and income received within the Price Control Period may be taken into consideration*"[18]. Also, consideration of the proposed adjustment may be premature at this stage since SPEN has not yet incurred expenditure and no other DNO has yet proposed an adjustment despite HS2 being expected to traverse other licence areas.

SPEN (SPD) – Accelerated Electric Vehicle Investment

1. Does the submission meet the qualifying criteria set out in Special Licence Condition CRC3.F of the network companies' licences?

We do not believe this submission meets all the qualifying criteria. The proposed adjustments do not relate to an individual scheme. The HVP reopener was designed to allow adjustments for individual schemes of £25m or more not included as part of ex ante allowances[19]. Subsequently, in existing guidance, HVP costs have been defined as:

> *…scheme of works and the associated costs incurred, or expected to be incurred, by the licensee on any investment project with respect to its Distribution System that is reasonably forecast to cost the licensee £25 million or more (in 2012/13 prices) during the Price Control Period...*[20]

SPEN's submission relates to a portfolio of load-related investment projects to increase network capacity to accommodate the expected increase in demand due to the uptake of electric vehicles. In the submission, SPEN explains:

> *To accommodate this increase, significant reinforcement of distribution networks at all voltage levels will be required, with the most disruptive being wide-scale uprating of the LV and HV network. If significant changes in electrical network infrastructure and management are not made, networks cannot facilitate this demand. To best accommodate and enable this transition, SPEN believes wide-scale anticipatory network investment in the LV and HV system is required to enable a smooth EV transition and minimise economic disruption*.[21]

Again, SPEN's submission relates to a portfolio of load-related activities. We do not believe treating a portfolio of load-related activities equivalently to an individual scheme aligns with the underlying policy intent of this mechanism or the wording in the *Handbook*. Further, SPEN proposes the portfolio should by funded via the HVP reopener mechanism because the portfolio does not meet the criteria for other reopeners[22]. We disagree with this approach. Whether the proposed adjustment cannot be made under the provisions of any other Special Licence Condition is just one of the qualifying criteria. The other qualifying criteria must be satisfied.

[18] See Special Licence Condition CRC3.G.
[19] "Strategy decision for the RIIO-ED1 electricity distribution price control - Uncertainty mechanisms"; page 22.
[20] "ED1 Price Control Financial Handbook (slow-track licensees)"; paragraph 7.21.
[21] SPEN's Electric Vehicles Accelerated Investment submission, page 2.
[22] SPEN's Electric Vehicles Accelerated Investment submission, page 25.

2. Does the submission provide adequate evidence that the planned expenditure is necessary?
3. Does the submission provide adequate evidence that the planned expenditure is economic and efficient?

Consideration of the proposed adjustment may be premature at this stage since no other DNO has yet proposed an adjustment despite all being exposed to the UK and Scottish Governments' policies SPEN identified in its submission.

4. Is there any other relevant information we should consider before making our determination?

The provision of additional ex-ante funding for investment to accommodate the uptake of electric vehicles was addressed when Ofgem decided not to conduct a Mid-Period Review for the RIIO-ED1 price control. Ofgem highlighted that consumers' electricity use could change during the ED1 price control and that reopeners, including the LRE reopener, can accommodate these changes[23]. We agree. LRE has been defined as costs incurred for various reasons including "*…the accommodation of Distributed Generation and low-carbon devices onto the Distribution System…*"[24]. As such, the LRE reopener is clearly the appropriate mechanism through which SPEN should propose adjustments. Additionally, the LRE reopener offers consumers some protection in the event the assumed increase in demand does not materialise.

SSEN (SHEPD) Pentland Firth East Cable

1. Does the submission meet the qualifying criteria set out in Special Licence Condition CRC3.F of the network companies' licences?

The non-confidential submission appears to meet the qualifying criteria.

2. Does the submission provide adequate evidence that the planned expenditure is necessary?
3. Does the submission provide adequate evidence that the planned expenditure is economic and efficient?
4. Is there any other relevant information we should consider before making our determination?

[23] "Decision on a Mid-Period Review for RIIO-ED1"; paragraph 2.10: https://www.ofgem.gov.uk/system/files/docs/2018/04/decision_on_a_mid-period_review_for_riio-ed1_0.pdf.
[24] "RIIO-ED1 regulatory instructions and guidance: Annex A – Glossary"; page 110: https://www.ofgem.gov.uk/system/files/docs/2019/04/rigs_guidance_documents_v5.0_clean_copy.zip.

The non-confidential submission does not provide adequate evidence that the planned expenditure is necessary or is economic and efficient. The information that has been redacted may have provided additional justification.

We note the recent consultation on the Needs Case for the Orkney transmission project[25]. The Orkney transmission project and the project for which SSEN proposed an adjustment both connect Orkney to mainland Scotland. We encourage Ofgem to consider both projects holistically, to assess whether both projects, if undertaken, provide value for money for consumers.

[25] See: https://www.ofgem.gov.uk/publications-and-updates/orkney-transmission-project-consultation-final-needs-case-and-potential-delivery-models.

Appendix 2:
Assessment of Rail Electrification Costs submissions

SSEN (SEPD) – Great Western Railway Electrification

1. Does the submission meet the qualifying criteria set out in Special Licence Condition CRC3.F of the network companies' licences?

The non-confidential submission appears to meet the qualifying criteria.

3. Does the submission provide adequate evidence that the planned expenditure is economic and efficient?

The non-confidential submission does not provide adequate evidence that the planned expenditure is economic and efficient. The information that has been redacted may have provided additional justification.

4. Is there any other relevant information we should consider before making our determination?

We note two companies proposed adjustments via the Rail Electrification reopener. The companies' views differ as to whether a policy decision has been made about how diversions should be funded and whether it has been confirmed electricity consumers should fund those costs.

It would have been helpful if the policy relating to funding was confirmed ahead of the 2019 reopener window. Nevertheless, we acknowledge ex-ante expenditure allowances have been provided on an interim basis in the RIIO-ED1 settlement and Ofgem has confirmed the funding will be returned to consumers if the works are to be funded by a third party. If additional allowances are provided via this reopener, this should be done on the same proviso. Additionally, we recommend Ofgem retains the ability to return funding to consumers beyond the end of the RIIO-ED1 price control, in the event the relevant policy decision is made after March 2023.

SPEN (SPMW) – HS2 Rail Electrification

1. Does the submission meet the qualifying criteria set out in Special Licence Condition CRC3.F of the network companies' licences?

We do not believe this submission meets the qualifying criteria. The proposed adjustments do not relate to an existing railway line. Rail Electrification is defined as:

> *Electrification of an existing railway line. Defined here in connection with Diversions activity, where the installation of rail electrification equipment requires the relocation or re-routing of DNO apparatus.*[26]

SPEN's submission relates to diversions to accommodate the HS2 route. Based on the evidence in the submission, the diversions appear to be required to accommodate a new railway line. For example, SPEN states:

> *When completed, HS2 will provide the new backbone of the national rail network - directly connecting London, Birmingham, the East Midlands, Leeds and Manchester via a dedicated new-build high speed rail route. Part of the route will pass through SPMW's licence area.*[27]

We, therefore, do not believe adjustments for diversions to accommodate a new railway line via the Rail Electrification reopener mechanism aligns with the *RIIO-ED1 regulatory instructions and guidance*.

2. Does the submission provide adequate evidence that the planned expenditure is necessary?
3. Does the submission provide adequate evidence that the planned expenditure is economic and efficient?

The non-confidential submission does not provide adequate evidence that the planned expenditure is economic and efficient from the consumer perspective since there remains uncertainty whether electricity consumers are required to fund rail diversions. Additionally, we do not believe this reopener mechanism can be used to fund diversions associated with new railway lines.

4. Is there any other relevant information we should consider before making our determination?

Policy confirmation:
We note two companies proposed expenditure adjustments via the Rail Electrification reopener. Notwithstanding our views on the use of this mechanism to fund diversions for a new railway line as outlined above, we recognise the companies' differing views as to whether a policy decision has been made about how diversions should be funded and whether it has been confirmed electricity consumers should fund those costs.

It would have been helpful if the policy relating to funding was confirmed ahead of the 2019 reopener window. Nevertheless, we acknowledge ex-ante expenditure allowances have been provided on an interim basis in the RIIO-ED1 settlement and Ofgem has confirmed the funding will be returned to consumers if the works are to be funded by a third party. If additional allowances are provided via this reopener, this should be done on the same proviso. Additionally, we recommend Ofgem retains the ability to return funding to consumers beyond the end of the RIIO-ED1 price control, in the event the relevant policy decision is made after March 2023.

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[26] "RIIO-ED1 regulatory instructions and guidance: Annex A – Glossary"; page 161.
[27] SPEN's HS2 HVP & Rail Electrification submission, page 3.

Funding return mechanism:

Notwithstanding our views on the use of this mechanism to fund diversions for a new railway line as outlined above, we recommend Ofgem retains the ability to return funding to consumers in the event the funding is no longer needed because the HS2 project is cancelled or scaled down. This would avoid in the scenario in which arrangements could not facilitate the automatic return of ex-ante allowances provided to Western Power Distribution after the Great Western Railway project was scaled down[28].

[28] "Decision on a Mid-Period Review for RIIO-ED1"; paragraphs 3.8-3.11.

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Appendix 3:
Assessment of Enhanced Physical Site Security Costs submissions

NPg - Enhanced Physical Site Security Costs

1. Does the submission meet the qualifying criteria set out in Special Licence Condition CRC3.F of the network companies' licences?

The non-confidential submission appears to meet the qualifying criteria.

3. Does the submission provide adequate evidence that the planned expenditure is economic and efficient?

The non-confidential submission does not provide adequate evidence that the planned expenditure is economic and efficient.

4. Is there any other relevant information we should consider before making our determination?

If an adjustment is made, relevant expenditure is reviewed at the end of the price control and allowances provided for any sites that may be declassified should be returned to consumers, as has been considered for the RIIO-T1 and RIIO-GT1 price controls[29]. Ex-ante allowances provided during the RIIO-ED1 price control review should also be reviewed.

[29] "RIIO-GT1 and RIIO-GD1: Our decision on applications from National Grid Electricity Transmission plc, National Grid Gas Transmission plc and Wales & West Utilities Limited's application under the Enhanced Physical Site Security Costs reopener"; page 6: https://www.ofgem.gov.uk/system/files/docs/2018/09/enhanced_physical_site_security_costs_decision.pdf.

Appendix 4:
Assessment of Specified Street Works Costs submissions

NPg, WPD, UKPN, SSEN and ENW - Specified Street Works Costs

1. Does the submission meet the qualifying criteria set out in Special Licence Condition CRC3.F of the network companies' licences?

The non-confidential submissions appear to meet the qualifying criteria.

3. Does the submission provide adequate evidence that the planned expenditure is economic and efficient?

We note the wide variation in costs per licence area. Robust benchmarking should help identify whether planned expenditure is economic and efficient.

4. Is there any other relevant information we should consider before making our determination?

We note that, in the non-confidential submission, network companies highlight that the number of authorities operating lane rental schemes is expected to increase over the remainder of the RIIO-ED1 but propose differing ways in which these costs should be treated. We recommend these costs are consistently treated all network companies.